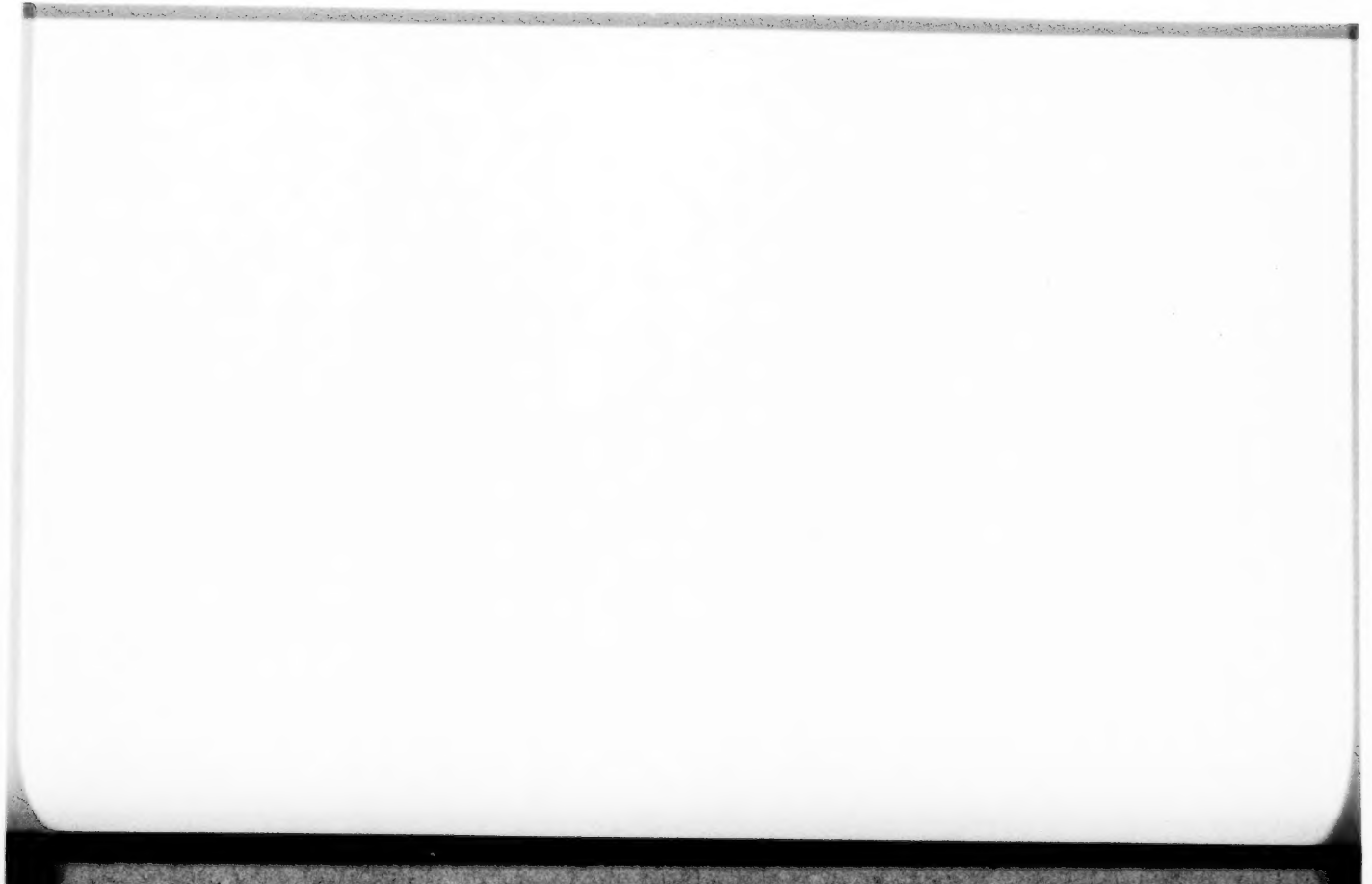

Nos. 631 and 632

In the

THE PENNSYLVANIA
ON LIVES
PETITIONER

THE

THE PENNSYLVANIA
ON LIVES
PETITIONER

THE

ON PETITION
STATES
CIRCUIT

BRIEF

# INDEX



## CITATIONS



576662—44——1

# In the Supreme Court of the United States

OCTOBER TERM, 1943

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No. 691

THE PENNSYLVANIA COMPANY FOR INSURANCES ON LIVES AND GRANTING ANNUITIES, ETC., PETITIONER

*v.*

THE UNITED STATES OF AMERICA

---

No. 692

THE PENNSYLVANIA COMPANY FOR INSURANCES ON LIVES AND GRANTING ANNUITIES, ETC., PETITIONER

*v.*

THE UNITED STATES OF AMERICA

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*ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT*

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## BRIEF FOR THE UNITED STATES IN OPPOSITION

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### OPINIONS BELOW

The opinion of the Circuit Court of Appeals for the Third Circuit (R. 65–75) is reported in 138 F. 2d 869, and the opinions of the District

Court of the United States for the Eastern District of Pennsylvania (R. 30a–34a, 61a) are reported in 48 F. Supp. 969, 972.

### JURISDICTION

The judgments of the Circuit Court of Appeals were entered on November 16, 1943 (R. 75, 76). The petition for writs of certiorari was filed February 11, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

### QUESTION PRESENTED

Whether certain trusts, of which petitioner was trustee under each of two trust agreements, one entered into by it with Capital Savings Plan, Inc., and one with Wellington Foundation, Inc., were associations in the taxable years in question, within the provisions of Section 1001 of the Revenue Act of 1936, Section 901 of the Revenue Act of 1938 and Section 3797 of the Internal Revenue Code.

### STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations will be found in the Appendix, *infra,* pp. 17–23.

### STATEMENT

Petitioner, the Pennsylvania Company for Insurances on Lives and Granting Annuities, called the trustee, entered into separate trust agreements with Capital Savings Plan, Inc., and Wellington

Foundation, Inc., commonly referred to as the sponsor[1] or as the distributor,[2] and sometimes as the depositor[3] (R. 2a, 38a; Pet. 41–86, 87–119). The so-called trust declared by each agreement

[1] See Report of the Securities and Exchange Commission, made pursuant to Section 30 of the Public Utilities Holding Company Act of 1935, regarding Investment Trusts and Investment Companies, pamphlet entitled "Fixed and Semifixed Investment Trusts," p. 11, also particularly pamphlet "Companies Sponsoring Installment Investment Plans," pp. 4, 16–17, 107–111. The following is a complete list of the various pamphlets of which this report is composed:

Investment Trusts and Investment Companies, Part One, The Nature, Classification, and Origins of Investment Trusts and Investment Companies (also published as H. Doc. No. 707, 75th Cong., 3d Sess., serial No. 10,262); Part Two, Statistical Survey of Investment Trusts and Investment Companies; Part Three, Chapters 1 and 2, Abuses and Deficiencies in Organization and Operation of Investment Trusts and Investment Companies; Part 3, Chapters 3, 4, and 5, same title; Part 3, Chapter 6, same title; Part 3, Chapter 7, same title; Parts Four and Five—Part 4, Control and Influence Over Industry and Economic Significance of Investment Companies; Part 5, Conclusions and Recommendations.

Investment Trusts and Investment Companies, Investment Trusts in Great Britain.

Investment Trusts and Investment Companies, Fixed and Semifixed Investment Trusts.

Investment Trusts and Investment Companies, Commingled or Common Trust Funds Accumulated by Banks and Trust Companies.

Investment Trusts and Investment Companies, Companies Sponsoring Installment Investment Plans.

[2] Same report, pamphlet entitled "Companies Sponsoring Installment Investment Plans," pp. 16–17.

[3] *Commissioner* v. *Chase Nat. Bank*, 122 F. 2d 540 (C. C. A. 2d); *Commissioner* v. *North American B. Trust*, 122 F. 2d 545 (C. C. A. 2d).

was what investment brokers commonly call an investment trust of the "semifixed" type. By this is meant an investment trust whose management, consisting of the sponsor and trustee acting in combination, has the power, though limited, to vary the investment underlying the so-called trust shares represented by trust share certificates (R. 34a, 61a), which the trustee issued and which the sponsor sold to the public generally.[4] As of October 1, 1940, Capital Savings Plan, Inc., had 593 contracts outstanding (R. 8a). During the calendar year 1937 the trustee sold trust shares to 258 investors (R. 9a–10a). Under the Wellington Foundation, Inc., trust agreement 7,110 certificates were issued. As of May 1, 1941, there were 5,300 certificates outstanding.[5] (R. 44a.)

In the case involving the Pennsylvania Company's agreement with Capital Savings Plan, Inc., the trust shares consisted of shares of stock

[4] For a full discussion of the difference between fixed and semifixed investment trusts, on the one hand, and management investment trusts, on the other, see the separate pamphlet of the same report entitled "Fixed and Semifixed Investment Trusts," generally, and particularly pp. 1–9.

[5] Notoriously, the sales were to a large extent made by house-to-house canvassing, as that was the only way the plans could be sold. See Report of the Securities and Exchange Commission, pamphlet entitled "Companies Sponsoring Installment Investment Plans," pp. 13, 18, 143–144. Thus, Capital Savings Plan, Inc., was primarily a sales organization. *Ibid.*, p. 144.

of Independence Shares Corporation, another Pennsylvania investment company, until December 31, 1938, when Capital Savings Plan, Inc., and Independence Shares Corporation merged. Since that time, Independence Shares Corporation has sold those shares. (R. 2a–3a.) In the case involving the Pennsylvania Company's agreement with Wellington Foundation, Inc., the trust shares at all times consisted of the shares of stock of Wellington Fund, Inc., another Pennsylvania investment trust company[6] (R. 38a–39a). These trust shares were purchased by the trustee as funds became available (R. 6a, 43a). They were evidenced by Trust Share Certificates which were from time to time issued to the investor by the sponsor upon the investor's written application

[6] The trust shares of other sponsor corporations represent interests in shares called trust share units of corporate stocks and bonds created by the sponsor. Units of this type were involved in *Commissioner* v. *Chase Nat. Bank*, 122 F. 2d 540 (C. C. A. 2d), and *Commissioner* v. *North American B. Trust*, 122 F. 2d 545 (C. C. A. 2d), as also in two other cases decided by the District Court of the United States for the Eastern District of Pennsylvania against the United States, which are now pending on appeal by the United States in the United States Circuit Court of Appeals for the Third Circuit, one involving an agreement between the Pennsylvania Company and Independence Shares Corporation, with which Capital Savings Plan, Inc., was merged as aforesaid, and the other an agreement between the Pennsylvania Company and Bank and Insurance Shares, another Pennsylvania investment trust corporation.

therefor accompanied by an initial payment, the name of the investor being then entered in the trustee's registry book kept for that purpose (R. 4a, 39a–40a). The certificates were of several types. One type was sold on the installment plan; another of the same type had added insurance benefits, and the third was a fully paid up certificate (R. 3a, 39a). The deposited securities were held by the trustee in what in effect was a revolving fund, and each certificate (to the extent that it was paid for in full) represented an equal *pro rata* share thereof or interest therein (Pet. 45–49, 69–71, 90–93). The certificates were transferable on the books of the trustee kept for that purpose pursuant, however, to a somewhat stricter ritual than is generally observed in connection with the transfer of corporate stocks (Pet. 84–85, 89). Dividends received by the sponsor upon the deposited stock were paid by it to the trustee and were carried by it in a cash account, in which were also deposited proceeds from the sale of eliminated securities, as well as other cash received (R. 8a, 45a). An investor in a trust share certificate had the option of having his certificate redeemed by the payment to him out of the cash funds of the trust of the value of the shares in the deposited security represented by the certificate he held, or to receive the number of shares of such securities which the trust shares he owned represented, plus cash accumulations in the

trustee's hands which were allocable thereto[7] (R. 5a–6a, 42a). In the event an investor elected to have his certificate redeemed in cash, the underlying shares of stock were sold (R. 7a, 42a–43a). A surrendered certificate was marked "Liquidated" (R. 6a, 43a). Distributions on trust shares were remitted to the investors in additional trust shares (R. 5a, 41a–42a). The trustee kept a separate account with each certificate holder, in which his *pro rata* interest in the deposited securities, carried out to the third decimal place, was entered (R. 6a, 42a). All work in connection with the trust's activities was performed by the employees of the Pennsylvania Company, which used its own stationery (R. 8a, 44a–45a). The investors had no voting rights. The trust agreement did not provide for meetings of the investors and none was held. The trust had no directors, officers, or employees; nor had it any stationery, seal or minute book. (R. 9a, 46a.) The trust agreement contained elaborate provisions limiting the liability of the trustee (Pet. 51–54). See also

[7] The right of the certificate holder thus to have his trust shares redeemed characterizes the organization as an "open-end" investment trust, as distinguished from a "closed-end" investment trust, which does not have the redemption feature. See Report of the Securities and Exchange Commission, pamphlet entitled "Part One, The Nature, Classification, and Origins of Investment Trusts and Investment Companies," pp. 1–2, 27–28. See also reference thereto in the same report, pamphlet entitled "Companies Sponsoring Installment Investment Plans," p. 4.

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Article V (p. 16) of the Wellington Foundation Trust Agreement (R. 47a). Capital Savings Plan, Inc., was ultimately merged with Independence Trust Shares Corporation, whose stock was deposited by Capital Savings Plan, Inc., with the trustee and represented the underlying security for the trust shares that corporation had sold under its agreement aforesaid with the Pennsylvania Company (R. 3a). Each trust was terminable in any event on a given date (Pet. 58–61, 113).

Both the sponsor and the trustee received certain fixed fees for the services each performed payable out of the funds of the trust (Pet. 45, 77–78, 81–84). See also Article V, Section 5.03 (p. 19) of the Wellington Foundation, Inc., agreement (R. 47a).

Each trust agreement contained provisions with similar import, regarding the sponsor's right to vary the investment. Thus, each sponsor was under limited circumstances and upon notice to the trustee permitted to substitute shares of stock of another investment corporation owning reasonably comparable securities, or, alternatively, certain bank and trust company obligations approved by the trustee and representing trust shares of a similar nature (Pet. 56–57, 94–97).

The District Court concluded that the trust in each of the cases, was an association taxable as a corporation (R. 34a, 61a) and accordingly en-

tered a judgment in each case in favor of the United States (R. 35a, 62a). The basis of its decision was that in each case the trustee had the power to vary the investment which was not confined to the same stock which had been selected for the first unit (R. 30a–34a, 61a). Accordingly, the District Court held that the trust agreements in the cases at bar fell within the principles announced by the Circuit Court of Appeals for the Second Circuit in the case of *Commissioner* v. *North American B. Trust,* 122 F. 2d 545 (R. 34a).

The court below affirmed the judgments of the District Court, holding that both trusts were business trusts whose set-up in every substantial particular met the *quasi* corporate form test laid down by this Court in the case of *Morrissey* v. *Commissioner,* 296 U. S. 344 (R. 65–75). In describing the nature of the business in which each was engaged, the court below said that the facts justified the conclusions that the trust device was adopted here and had been used to facilitate the distributors' sales of their trust shares among many small investors whose net aggregate contributions were utilized by the trustee from day to day for that purpose and that the participation of the beneficiaries as investors in trust shares, through the medium of the trustee, was for the hope of return by way of dividends and of gain through the possible enhancement in the value of the trust

shares, concluding that their participation could hardly be said to be for the achievement of the security and preservation of property which is ordinarily the purpose of a trust (R. 74). The court further stated that the trusts fell within the principle of the *North American B. Trust* case, since here, as there, the trustee had the qualified power to vary the investment by substituting different corporate securities from those originally deposited.

ARGUMENT

1. Petitioner does not contend that the decision of the court below is in conflict with a decision of any Circuit Court of Appeals, but asserts a conflict with the decision of this Court in *Morrissey* v. *Commissioner,* 296 U. S. 344. The principles established by the *Morrissey* case are, of course, controlling here, but as that case involved a real estate trust which was held to be an association, the decisions below cannot be in direct conflict with that decision. Essentially petitioner's argument is merely that the trusts here do not meet either the business test or the corporate form test laid down by this Court in the *Morrissey* case. But, even if this were so, it would not establish a conflict which would justify a review by this Court.

2. In deciding this case the court below correctly applied the business test as defined in the *Morrissey* case. In that case, this Court distin-

guished between business trusts, the object of which was to provide a medium for the conduct of a business and the sharing of its gains, and a trust whose object is to hold and conserve particular property with incidental powers as in the traditional type of trust. It included within the former category trusts created as a convenient means by which persons become associated for dealings in real estate, the development of tracts of land, the construction of improvements, the purchase, management and sale of properties, or dealings in securities or other personal property, where those who become beneficially interested either by joining in the plan at the outset or by later participation according to the terms of the arrangement seek to share the advantages of a union of their interests in a common enterprise (296 U. S. 344, 357). In the case at bar the purpose of all the parties was profit, not the conservation of properties, so the holding of the court below that this trust was a business trust is precisely in accord with the rules laid down in the *Morrissey* case. Moreover, the decision follows the regulations, which specifically provide that all investment trusts are to be regarded as associations. Art. 1001–2 of Regulations 94, Appendix, *infra,* pp. 18–19.

Petitioner's contention that the decision below does not conform to the business test is based chiefly on the ground (Br. 26–29) that limita-

tions upon the power of the sponsor corporations acting in conjunction with the trustee to vary the investments of the trusts prevented their activities from being classified as business activities. In so arguing, petitioner relies primarily on the decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Chase Nat. Bank,* 122 F. 2d 540 (Br. 26–29). But neither that decision nor the decision of the Circuit Court of Appeals for the Ninth Circuit in *Commissioner* v. *Buckley,* 128 F. 2d 124, which followed the *Chase Nat. Bank* case as applied to a substantially identical trust, held that a semifixed investment trust, such as the one here involved, would not be considered as having the business activities necessary to constitute an association. In the *Chase Nat. Bank* case, each unit was to be composed of sixteen shares of stock of thirty specified companies. Shares could be eliminated from the portfolio only under exceptional circumstances and, when the number of corporations represented fell below sixteen, the agreement was to be terminated. There was no power to substitute shares of other corporations. In the cases at bar there was a power of substitution of shares of other investment trusts comprising the original portfolio, although the power was qualified. The decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *North American B. Trust,* 122 F. 2d 545, rendered on the same

day as the *Chase Nat. Bank* decision, makes it clear that if the *Chase Nat. Bank* case had involved even a limited power to change investments, the decision in that case would have gone the other way. Indeed petitioner recognizes as much, for it challenges the *North American B. Trust* decision as wrong (Pet. 38), and does not urge that it is distinguishable, as it is not, from the instant case.

3. Courts that have previously passed on the question have not entertained any doubt that investment trusts meet the other test applied in the *Morrissey* case, the corporate form test. *Commissioner* v. *Chase Nat. Bank, supra; Commissioner* v. *North American B. Trust, supra; Commissioner* v. *Buckley, supra; Hamilton Depositors Corp* v. *Nichols,* 111 F. 2d 385 (C. C. A. 10th). That such trusts do, appears to have been assumed without discussion.

Petitioner argues (Br. 21–26) first, that the corporate form test is merely a secondary test, since the five factors which this Court enumerated in the *Morrissey* case, namely, continuity, centralized management, security from termination or interruption by the death of owners of beneficial interest, facilitation of transfer of beneficial interests and the introduction of large numbers of participants without affecting continuity of the enterprise, and limitations on liability, are as often found in trusts as in corporations; and,

second, that the trusts here do not, in any event, meet that test. While the fact that all trusts have some characteristics common to corporations may make the business test the more important, petitioner's argument (Br. 24–26) erroneously assumes that the *Morrissey* case requires that the organization and operation of the trust must conform in every detail to that of a corporation, a situation that of necessity will not exist as to any trust, and disregards the fact that to the extent the corporate form test is of significance it requires a determination not of the extent to which the particular trust has the characteristics of a trust, but the extent to which it has features resembling those of a corporation.

As the court below pointed out (R. 73–74), these trusts had corporate attributes, and moreover they lacked many of the features of a pure trust. Petitioner does not deny the possession of these corporate attributes (Pet. 25–26) except for that of limited liability. Petitioner's contention that the liability of beneficiaries was not limited is rested on the failure of the agreements expressly to limit liability. However, normally a trust beneficiary is not personally liable for the debts of the trust (*Restatement of the Law of Trusts*, Vol. 2, §§ 274–277, pp. 842–847; Scott, *Law of Trusts* (1939), Vol. 2, §§ 274–277, pp. 1540–1544), as this Court recognized in *Helvering* v. *Combs*,

296 U. S. 365, a companion case to *Morrissey* v. *Commissioner, supra,* where it referred to the limited liability of the associates although no express limitation of liability was shown by the record. For other cases holding trusts taxable as associations in the absence of express limitations of liability, see *Nashville Trust Co.* v. *Cotros,* 120 F. 2d 157, 159, 122 F. 2d 326 (C. C. A. 6th), certiorari denied, 314 U. S. 680; *Del Mar Addition* v. *Commissioner,* 113 F. 2d 410, 411 (C. C. A. 5th); *Kilgallon* v. *Commissioner,* 96 F. 2d 337 (C. C. A. 7th), certiorari denied, 305 U. S. 622; *Bert* v. *Helvering,* 92 F. 2d 491 (App. D. C.); *Huron River Syndicate* v. *Commissioner,* 44 B. T. A. 859, 864; *Jordan Creek Placers* v. *Commissioner,* 43 B. T. A. 131, 135; and compare *Burk-Waggoner Assn.* v. *Hopkins,* 269 U. S. 110, holding a partnership taxable as an association.

These trusts are unlike pure trusts in many respects. The sponsors are not trustors but vendors of securities; the trustees are not true trustees but intermediaries; the certificate holders are not ordinary beneficiaries but were purchasers of interests in corporate securities; the trust assets were not donated by trustors but were contributed by the certificate holders in the same manner that corporate shareholders provide their corporation with capital.

## CONCLUSION

The decision below is correct and presents no conflict. The petition for writs of certiorari should be denied.

Respectfully submitted.

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MARCH 1944.